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TREATMENT OF FLUCTUATING CURRENCY IN ACCOUNTS.

BY

A. E. CUTFORTH, A.C.A.

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INTRODUCTION.

IN the various books which treat of the subject of Foreign Exchange, it is unusual to find information as to the treatment of Fluctuating Currency in Accounts.

The following elementary book attempts to explain in detail this particular branch of the subject.

A. E. C.

February 1910.

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TREATMENT OF FLUCTUATING CURRENCY IN ACCOUNTS.

Case of an English Company having operations abroad.

IN considering the question of Exchange in relation to Accounts, we will take the ordinary case in which fluctuating currency is met with by Accountants in this country, viz., that of an English company whose head office is in London, and whose seat of operations is in a country where the currency fluctuates from day to day. The transactions abroad take place in this fluctuating currency, and these transactions, or the results of them, must be presented to the shareholders in England, translated into terms of pounds, shillings, and pence, as the capital of the company has been raised in sterling, and the dividends are distributed in sterling.

Simple example of transactions in foreign currency.

Commencing with a very simple case, we will imagine that an engineering firm in England sends out an engineer and several artisans to a country where there is a fluctuating paper currency, to do various work for firms abroad, to collect the fees in currency, to retain certain sums for their own wages and expenses, and to remit the net proceeds to England in the form of sterling bills on London. We will suppose that these operations take place in Chili, where the value of the currency dollar varies from day to day.

The engineer sends home statements every three months showing the gross earnings and the expenditure

during each month of the period, and the debtors and currency bank balance at the end of the period. He is also instructed to remit profits home whenever his currency bank balance has accumulated sufficiently to allow a sterling bill on London to be bought.

The following is a summary of the transactions for the first three months:—

Fees earned:	$
April	4,050.00
May	5,220.00
June	6,310.00
	$15,580.00

Wages and Expenses:	$
April	2,110.00
May	3,240.00
June	3,760.00
	$9,110·00

Cash received on account of Fees:	$
April	2,370.00
May	4,860.00
June	8,350.00
	$15,580.00

Remittances to London:

In April	None	
On May 25th ...	£55 os. od. cost	$1,200.00 at 11d.
On June 30th ...	258 os. 2d. „	5,270.00 „ 11¾d.

Rates of Exchange:

Average for April	10d.
Average for May	10¾d.
Average for June	11½d.

To simplify the example, I have supposed that no book debts remained at 30th June, and that the whole of the bank balance at that date was used in the purchase of a sterling bill. This would not be likely to occur, of course, in practice.

Entries in the Books abroad.

The engineer in charge would make the following entries in respect of the transactions of the three months :—

JOURNAL.

		$	$
Sundry Debtors...	*Dr.*	15,580.00	
To Fees earned			15,580.00
April $4,050.00			
May 5,220.00			
June 6,310.00			
Cash	*Dr.*	15,580.00	
To Sundry Debtors			15,580.00
Receipts during the three months—			
April... ... ... $2,370.00			
May... ... ... 4,860.00			
June.. ... ... 8,350.00			
Sundries	*Dr.*		
To Cash			15,580.00
Wages and Expenses		9,110.00	
April $2,110.00			
May 3,240.00			
June 3,760.00			
London Office, for Remittances—			
May $1,200.00			
June 5,270.00			
		6,470.00	
Profit and Loss Account ...	*Dr.*	9,110.00	
To Wages and Expenses ...			9,110.00
For Transfer of the latter Account.			

		$	$
Fees Account	*Dr.*	15,580.00	
To Profit and Loss Account ...			15,580.00
For Transfer of the former Account.			

Profit and Loss Account ...	*Dr.*	6,470.00	
To London Office			6,470.00
For Transfer of the Net Profits to London Office Books.			

LEDGER.

Sundry Debtors.

To Fees:	$	By Cash:	$
April	4,050.00	April	2,370.00
May	5,220.00	May	4,860.00
June	6,310.00	June	8,350.00
	$15,580.00		$15,580.00

Cash Account.

	$		$
April. To Sundry Debtors	2,370.00	April. By Wages and Expenses ..	2,110.00
May. ,, ,, ,,	4,860.00	May. ,, Do. do.	3,240.00
June. ,, ,, ,,	8,350.00	,, Remitted to London (£55 0 0)	1,200.00
		June. ,, Wages and Expenses ..	3,760.00
		,, Remitted to London (£258 0 2)	5,270.00
	$15,580.00		$15,580.00

Fees Earned.

	$		$
June 30. To Profit and Loss Account	15,580.00	April. By Sundry Debtors	4,050.00
		May. ,, ,, ,,	5,220.00
		June. ,, ,, ,,	6,310.00
	$15,580.00		$15,580.00

WAGES AND EXPENSES.

		$			$
April.	To Cash ..	.. 2,110.00	June 30.	By Profit and Loss Account	9,110.00
May.	,, ,, ..	.. 3,240.00			
June.	,, ,, ..	.. 3,760.00			
		$9,110.00			$9,110.00

PROFIT AND LOSS ACCOUNT.

		$			$
June 30.	To Wages and Expenses ..	9,110.00	June 30.	By Fees Earned	15,580.00
,,	To London Office Account:				
	April $1,940.00				
	May 1,980.00				
	June 2,550.00				
		6,470.00			
		$15,580.00			$15,580.00

LONDON OFFICE.

		$			$
May 25.	To Cash Remitted (£55 0 0)	1,200.00	By Profit and Loss Account:		
June 30.	To Cash Remitted (£258 0 2)	5,270.00	April	$1,940.00	
			May	1,980.00	
			June	2,550.00	
					6,470.00
		$6,470.00			$6,470.00

This completes the records abroad, and we now see what are the entries made in the London Office Books from the copies of the foreign accounts which are sent home.

Entries in the London Books.

The London Office has to convert the figures representing Chilian dollars into figures representing sterling. The business abroad has been carried on during the three

months in a currency which has fluctuated from day to day, and even from hour to hour. A fee may be *earned* one week when the dollar is worth 11d., and may be *received* the next week when the dollar is only worth 10½d.; yet another week may have elapsed before a portion of it (representing net profit) is *remitted* home to London in the form of a sterling draft, and the value of the dollar may then have further declined to 10d.

The best and most convenient way to express the nearest sterling equivalent to profits which are being made in currency, is to take the currency results of short periods of working, and to convert them into sterling at the *average rate of exchange* prevailing during the period. This method gives results which are as approximately correct as possible, and we will now apply it to the figures in the example.

BOOKS KEPT BY THE LONDON OFFICE.

JOURNAL.

		£	s	d	£	s	d
Cash in Transit	*Dr.*	313	0	2			
To Chilian Office					313	0	2

For following Remittances :—

Date sent	$	Rate	Sterling £	s	d
May 25	1,200	11d.	55	0	0
June 30	5,270	11¾d.	258	0	2
			£313	0	2

Chilian Office				*Dr.*	291	14	2	
To Profit and Loss Account ...								291 14 2
For Profit as shown by Chilian Accounts, converted at average monthly rates of exchange:—								
	$	Rate	Sterling £	s	d			
April	1,940	10d.	80	16	8			
May	1,980	10¾d.	88	13	9			
June	2,550	11½d.	122	3	9			
			£291	14	2			

Chilian Office				*Dr.*	21	6	0	
To Profit and Loss Account ...								21 6 0
Being Profit on Exchange.								

LEDGER.

Cash in Transit.

	£	s	d				
To Chilian Office ..	313	0	2				

Profit and Loss Account.

					£	s	d
				By Chilian Office ..	291	14	2
				,, Do. do. Profit on Exchange	21	6	0
					£313	0	2

Chilian Office.

	£	s	d		£	s	d
To Profit and Loss Account	291	14	2	By Remittances in transit	313	0	2
,, Do. do. Profit on Exchange ..	21	6	0				
	£313	0	2		£313	0	2

The above example shows exactly how the profit in exchange occurs, it being in this particular case the difference between the actual profits remitted home in gold, and the book profits arrived at by converting currency transactions at average rates.

Relation between Remittances sent home and Profits made abroad.

Unfortunately, in practice, it is impossible to earmark certain remittances as representing certain profits, and it is, therefore, impossible to find out exactly of what a difference in exchange is composed.

All currency profits may not be remitted home in sterling; some may be retained temporarily in floating assets, such as Stores and Book Debts, others permanently in Capital Expenditure, as found convenient. This must not be misunderstood by any confusion with the idea of an incorrect apportionment of expenditure as between Capital and Revenue; it is a matter of finance and not of accounts. Perhaps it will help to make the point clear if we leave exchange for a moment and consider the financing of a concern whose Head Office is in London, and whose operations are abroad. We will take as an example a Waterworks Company, whose revenue is collected in currency, whose profits average £50,000 a month, and are increasing, and whose works are being extended.

The remittances to London might be considerably less than £50,000 a month.

In the first place, the growing business implies growing book debts, which means that a larger figure representing past profits is wrapped up every month in the debts; the same applies to stores purchased locally.

Then, again, a large proportion of the Capital Expenditure would be in the form of wages paid in currency, so that some of the surplus currency would be used for this purpose instead of being remitted home.

It is quite possible that a fresh issue of Share Capital might be made in London to provide for the new Capital Expenditure abroad, but that the *actual money* thus raised might never be sent abroad, but might be used to pay dividends on the previously existing Share Capital, while the profits made abroad would be retained there to meet the Capital Expenditure. We see, then, that there is not necessarily any connection between sums remitted to London and profits; also that it is the aim of good financing to avoid as much as possible having to change the local currency into sterling, or *vice versâ*, because of the expense involved.

To return once more to the question of Exchange. So far we have only considered a case where, at the end of a financial period, there were no assets or liabilities in the foreign country, and consequently no balance on the foreign office account when the books were closed. This is, of course, quite contrary to ordinary experience, and we will now consider an example in which assets and liabilities occur. Before considering the working out of actual figures, we must recall for a moment the several entries to be found in the current account between a Head Office and a Branch. The Head Office debits the Branch with all money and stores sent out, and with profits made at the Branch, and credits it with remittances sent home. When Capital Expenditure is incurred at the Branch it

Usual entries to be found in the current account between a Head Office and a Branch.

is usual for the accounts representing this to be transferred from the Branch to the Head Office books at regular intervals, say once or twice a year. At the end of each year, when the profits and the capital expenditure have been transferred to the Head Office books, the balance on the "Branch Account" in the Head Office books represents the difference between the floating assets and the liabilities at the Branch.

Valuation of currency floating assets and liabilities.

Where there is no fluctuating currency to be reckoned with, a floating asset or liability remains at the same sterling value till liquidated, but where the value of the currency varies from day to day, the sterling value of a currency floating asset or liability is constantly changing; so that, when the position is summed up at the end of a financial period, the floating assets and liabilities must be valued in sterling, *not* at their worth when created (at which worth they have already been assessed in the books in arriving at the profits), *but* at their worth at the date of the Balance Sheet, according to the rate of exchange prevailing on that particular day. No one knows what their ultimate sterling value will be, as this depends on the rates of exchange prevailing at the future dates when they happen to be liquidated, so that the nearest possible valuation for Balance Sheet purposes is that as on the Balance Sheet date.

Valuation of Fixed Assets abroad.

The *Fixed Assets* which represent Capital Expenditure are dealt with in the accounts on another basis, the principle underlying the treatment of Capital Expenditure being that it must be ultimately stated in the books at its approximate sterling cost at the time it was incurred. The Capital Expenditure would mainly consist of stores

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used and wages paid, and, as we shall deal later on with the question of stores in general, we will for the moment imagine some Capital Expenditure to consist of wages only, and will compare the treatment of this fixed asset with that of a floating asset—*e.g.*, a book debt.

Difference between Treatment of Floating and Fixed Assets illustrated.

We will suppose that the foreign office of a trading concern creates the following assets in the following months :—

October—

A Book Debt of $1,000.00 for goods sold.

Wages expended on Capital Account, $5,000.00.

November—

A Book Debt of $800.00 for goods sold.

Wages expended on Capital Account, $6,000.00

and that it closes its books on the 31st December, at which date the above balances are still on its books.

The average rate of exchange for October is 11d., for November 1s., and the rate on the 31st December is 10½d.

The $1,000 and the $800 have been credited to Sales Account, and therefore Profit and Loss Account has had credit for them at the average rates of the two months in which the sales were made, as follows :—

	£	s	d
$1,000 at 11d.	45	16	8
$800 at 1s.	40	0	0
	£85	16	8

At the 31st December, when the books were balanced, neither of these currency debts had been collected, and the sterling value of them had fallen to £78 15s. (viz., $1,800 at 10½d.). It would obviously be unwise not to put against the credit of £85 16s. 8d. the difference of £7 1s. 8d., representing the depreciation in the value of the assets, as, so far as could be seen at the date of the Balance Sheet, they were only likely to realise £78 15s. The £7 1s. 8d. is therefore written off to Profit and Loss Account as a loss on exchange.

Now we come to the treatment of the $11,000 Capital Expenditure, of which $5,000 was spent in October, and $6,000 in November.

This asset is not going to be realised in gold at the current rate of exchange, and it would be incorrect to apply the rate of the 31st December to convert it into gold for the London books.

The Capital Expenditure is therefore converted into sterling at the rate of exchange prevailing at the time it was incurred; which is another way of saying that it is recorded at its approximate sterling cost.

In the example we are considering, the expenditure of $11,000 is converted into £529 3s. 4d. (viz., $5,000 at 11d., plus $6,000 at 1s.).

In order to prevent any errors in the conversion of Capital Expenditure it is usual to have a sterling Memorandum column in the Capital Expenditure Accounts in the books abroad, so that when the total expenditure for the year in currency is transferred to the London office,

the sterling equivalents at the various rates of exchange can be added up, producing the correct equivalent to the currency total.

It should be mentioned here that the London Office Account in the books kept abroad is often ruled with a Memorandum column for sterling, while the account in the London books representing the foreign office is also ruled with a Memorandum currency column.

Example embodying points already explained.

Before going any further, we will work out an example which embodies all the points upon which explanations have been given up to this point.

THE FOLLOWING PARTICULARS ARE TO BE RECORDED:—

In the London Books.

Balance of Foreign Office Account, January 1st, debit £375

In the Books Abroad.

January 1st.

	Dr.	*Cr.*
	$	$
Sundry Currency Book Debts...	10,000	
„ „ Creditors		4,000
„ Bank Balances	3,000	
London Office Account (at 10d. = £375) ...		9,000

Month of	Gross Earnings Receivable	Revenue Expenses Payable	Amount Payable to Contractors for Capital Work	Cash Receipts on account of Earnings	Cash Paid to Sundry Creditors	Cash Remitted to London
	$	$	$	$	$	
January..	50,000	28,000	5,000	40,000	20,000	15,000 at 9½d., producing £593 15s. (January 25th)
February	60,000	30,000	4,000	45,000	33,000	14,000 at 9¾d., producing £568 15s. (February 19th)
March ..	65,000	34,000	3,500	70,000	36,000	30,000 at 10¼d., producing £1,281 5s. (March 26th)

RATES OF EXCHANGE :—

At January 1st	10d.
Average for January	9d.
„ „ February	9½d.
„ „ March	10½d.
At March 31st	11d.

The following Journal entry states the balances in the books abroad as on January 1st.

OPENING JOURNAL ENTRY.

January 1st.

		$	$
Sundry Debtors	*Dr.*	10,000	
Cash at Bank		3,000	
To Sundry Creditors		...	4,000
„ London Office Account (£375) ...		...	9,000

JOURNAL ENTRIES FOR JANUARY.

January 31st.

		$	$
Sundry Debtors	*Dr.*	50,000	
To Profit and Loss Account			50,000
For Gross Earnings.			
Profit and Loss Account	*Dr.*	28,000	
To Sundry Creditors			28,000
For Expenses.			
Profit and Loss Account	*Dr.*	22,000	
To London Office (at 9d. = £825) ...			22,000
For Net Profit for month, transferred.			
Capital Expenditure (at 9d. = £187 10s.)	*Dr.*	5,000	
To Sundry Creditors			5,000
Cash	*Dr.*	40,000	
To Sundry Debtors			40,000
Sundry Creditors	*Dr.*	20,000	
London Office (produced £593 15s. at actual rate of 9½d.)		15,000	
To Cash			35,000

Journal Entries for February.

February 28th.

		$	$
Sundry Debtors	*Dr.*	60,000	
To Profit and Loss Account			60,000
For Gross Earnings.			
Profit and Loss Account	*Dr.*	30,000	
To Sundry Creditors			30,000
For Expenses.			
Profit and Loss Account	*Dr.*	30,000	
To London Office (at 9½d. = £1,187 10s.)			30,000
For Profit for the month, transferred.			
Capital Expenditure Account (at 9½d. = £158 6s. 8d.)	*Dr.*	4,000	
To Sundry Creditors			4,000
Cash	*Dr.*	45,000	
To Sundry Debtors			45,000
Sundry Creditors	*Dr.*	33,000	
London Office (£568 15s. at actual rate of 9¾d.)		14,000	
To Cash			47,000

Journal Entries for March.

March 31st.

		$	$
Sundry Debtors	*Dr.*	65,000	
To Profit and Loss Account			65,000
For Gross Earnings.			
Profit and Loss Account	*Dr.*	34,000	
To Sundry Creditors			34,000
For Expenses.			

		$	$
Profit and Loss Account	*Dr.*	31,000	
To London Office (at 10½d. = £1,356 5s.)			31,000
For Profit for the month, transferred.			
Capital Expenditure Account (at 10½d. = £153 2s. 6d.)	*Dr.*	3,500	
To Sundry Creditors			3,500
Cash	*Dr.*	70,000	
To Sundry Debtors			70,000
Sundry Creditors	*Dr.*	36,000	
London Office (£1,281 5s. at actual rate of 10½d.)		30,000	
To Cash			66,000
London Office (£498 19s. 2d.) ...	*Dr.*	12,500	
To Capital Expenditure Account ...			12,500
For transfer of Capital Expenditure for the three months.			

The credit balance of the London Office Account represents the floating assets less liabilities, and the sterling has been arrived at by attaching estimated and not realised sterling values to the currency transactions during the whole period. Now, at the end of the period, the floating assets, less liabilities, are valued in sterling at the rate on the particular day, and it is found that, instead of being £801 0s. 10d., as shown by the London Office Account, they are £939 11s. 8d., arrived at as follows:—

Bank Balances ...	$10,000	
Debtors	30,000	
	40,000	
Less Creditors ...	19,500	
		$20,500 at 11d. = £939 11s. 8d.

An entry is therefore made in the Credit sterling column of £138 10s. 10d., being profit on exchange. It

may seem odd at first sight that this entry appears to have no corresponding debit, but, as before-mentioned, the Sterling column in the books abroad is merely a Memorandum column, and not connected with the Double-entry System.

The amended balance of £939 11s. 8d., representing the value of $20,500 at that date, is then brought down upon the London Office Account at March 31st.

The following are the Ledger Accounts affected by the foregoing Journal entries:—

SUNDRY DEBTORS.

		$			$
Jan. 1.	To Balance ..	10,000	Jan. 31.	By Cash ..	40,000
31.	,, Fees	50,000	Feb. 28.	,, ,, ..	45,000
Feb. 28.	,, ,, ...	60,000	Mar. 31.	,, ,, ..	70,000
Mar. 31.	,, ,, ...	65,000		,, Balance c/d	30,000
		$185,000			$185,000
April 1.	To Balance ..	30,000			

CASH ACCOUNT.

		$			$
Jan. 1.	To Balance ..	3,000	Jan. 31.	By Sundry Creditors	20,000
31.	,, Sundry Debtors	40,000		,, London Office (£593 15s.)	15,000
Feb. 28.	,, ,, ,,	45,000	Feb. 28.	,, Sundry Creditors	33,000
Mar. 31.	,, ,, ,,	70,000		,, London Office (£568 15s.)	14,000
			Mar. 31.	,, Sundry Creditors	36,000
				,, London Office (£1,281 5s.)	30,000
				,, Balance c/d..	10,000
		$158,000			$158,000
April 1.	To Balance ..	10,000			

SUNDRY CREDITORS.

		$			$
Jan. 31.	To Cash.. ..	20,000	Jan. 1.	By Balance ..	4,000
Feb. 28.	„ „	33,000	31.	„ Sundry Expenses ..	28,000
Mar. 31.	„ „	36,000		„ Capital Expenditure ..	5,000
	„ Balance c/d..	19,500	Feb. 28.	„ Sundry Expenses ..	30,000
				„ Capital Expenditure ..	4,000
			Mar. 31.	„ Sundry Expenses ..	34,000
				„ Capital Expenditure ..	3,500
		$108,500			$108,500
			April. 1.	By Balance b/d..	19,500

PROFIT AND LOSS ACCOUNT.

		$			$
Jan. 31.	To Expenses ..	28,000	Jan. 31.	By Gross Earnings	50,000
	„ London Office (£825)	22,000			
		$50,000			$50,000

		$			$
Feb. 28.	To Expenses ..	30,000	Feb. 28.	By Gross Earnings	60,000
	„ London Office (£1,187 10s.)	30,000			
		$60,000			$60,000

		$			$
Mar. 31.	To Expenses ..	34,000	Mar. 31.	By Gross Earnings	65,000
	„ London Office (£1,356 5s.)	31,000			
		$65,000			$65,000

Capital Expenditure Account.

		Rate	£ s d	$			£ s d	$
Jan. 31	To Sundry Creditors ..	9d.	187 10 0	5,000	Mar. 31	By London Office ..	498 19 2	12,500
Feb. 28	,, ,, ,,	9½d.	158 6 8	4,000				
Mar. 31	,, ,, ,,	10½d.	153 2 6	3,500				
			£498 19 2	12,500			£498 19 2	12,500

London Office Account.

		Rate	£ s d	$			Rate	£ s d	$
Jan. 25	To Remittance ..	9½d.	593 15 0	15,000	Jan. 1	By Balance ..	10d.	375 0 0	9,000
Feb. 19	,, ,, ..	9¾d.	568 15 0	14,000	31	,, Profit and Loss Account ..	9d.	825 0 0	22,000
Mar. 26	,, ,, ..	10¼d.	1,281 5 0	30,000	Feb. 28	,, Do. do. ..	9½d.	1,187 10 0	30,000
31	,, Capital Expenditure transferred, viz :—		498 19 2	12,500	Mar. 31	,, Do. do. ..	10½d.	1,356 5 0	31,000
	$5,000 @ 9d.								
	4,000 @ 9½d.								
	3,500 @ 10½d.								
	$12,500								
	To Balance carried down	11d.	939 11 8	20,500		,, Difference, being Profit on Exchange ..		138 10 10	
		£	3,882 5 10	92,000				£3,882 5 10	92,000
					Apr. 1	By Balance ..	11d.	939 11 8	20,500

TRIAL BALANCE, 31st March.

	Dr.	Cr.
Bank Balance ...	10,000	
Sundry Debtors ...	30,000	
Sundry Creditors ...		19,500
London Office ...		20,500
	40,000	40,000

How the difference in exchange shown in the foregoing example arises.

The foregoing example is worthy of careful study, as it illustrates clearly the manner in which a difference in exchange appears in accounts; the London Office Account in particular should be studied, as the position is really summarised therein. Without converting into sterling every single currency transaction throughout the period at the rate prevailing when it took place (the labour involved in which would be enormous), it is impossible to tell exactly how the profit on exchange of £138 10s. 10d. is made up. Part of it may be caused by the difference between the £375 at which the floating assets of $9,000 at 1st January were valued and the gold they ultimately realised; part of it, again, may be due to the fact that a favourable rate of exchange happened to prevail at the date when the large remittance of £1,281 5s. was made. Again, part of it may be due to the high rate of exchange (viz., 11d.) applied to value the floating assets at 31st March.

Broadly speaking, the difference in exchange is the difference between *book* profits shown by applying average rates of exchange to transactions which have taken place at many different rates, and *actual* profits arrived at by valuing the various assets and liabilities, th

gold assets and liabilities being valued exactly and the currency ones approximately.

In other words, the difference in exchange is the difference between the profits as shown by the Profit and Loss Account, and the profits as shown by the Balance Sheet, the latter being the more correct profits.

Note.—Example 1 at the end of the book (see p. 50), may conveniently be worked out at this point.

Treatment of Stores Accounts.

We will now consider the keeping of accounts to record the receipt and issue of stores in a country where the currency is a fluctuating one. Stores Accounts must be kept on a gold basis; and to explain what this means, and to appreciate the necessity for it, we will see what would be the effect were these accounts kept on a currency basis.

Stores Accounts to be kept on a Gold basis.

Example showing fallacy of keeping Stores Accounts on a Currency basis.

We will imagine that, in December, stores are bought for $1,000, of which half are used in January on Capital Account, and the other half in February on Revenue Account. The average rate of exchange for December is 10d., for January 10½d., and for February 11d. If the Stores Accounts were kept on a currency basis, the entries relating to the above transactions would be as follows :—

				$	$
Dec.	Stores Account		*Dr.*	1,000	
	To Sundry Creditors				1,000
	For Stores bought.				
Jan.	Capital Expenditure Account		*Dr.*	500	
	To Stores Account				500
	For Stores issued.				

			$	$
Feb.	Revenue Account (under various heads)	*Dr.*	500	
	To Stores			500
	For Stores issued.			

In dealing with the Balances at the 31st December, the London office would value the stores on hand at cost, viz., at £41 13s. 4d. ($1,000 at 10d.).

In converting the January transactions, the Capital Expenditure Account would become £21 17s. 6d. (viz., $500 at 10½d.); while in converting the February figures, Revenue would be debited with £22 18s. 4d. (viz., $500 at 11d.).

Thus Stores which had cost £41 13s. 4d. would be charged out at £44 15s. 10d. (viz., £21 17s. 6d. to Capital, plus £22 18s. 4d. to Revenue). This is obviously incorrect, and it remains to find a way of dealing with Stores Accounts so that Stores issued are shown at their approximate sterling cost.

Method of keeping Stores Accounts on a Gold basis.

The method which is adopted, and which correctly records the transactions, is to add a fixed Standard Figure column to the Stores Account, and to make all Stores issues in figures of fixed value, converting all Stores received into the same standard figures, thus ensuring that all Stores shall be issued at the same actual value as received. The Standard Value column is memorandum only, and forms no part of the Double-entry System. The following explanations will help to make this method clear.

Transactions shown in preceding example now treated correctly on a Gold basis.

Taking once more the figures we have just considered, the December Journal entry must contain the standard equivalent with which to enter up the Memorandum column in the Stores Account. What standard is adopted does not matter; it might be expressed in pounds, shillings, and pence, but as these are inconvenient to work with and convert, a Dollar Standard is usually adopted, and in this particular case we will take a standard dollar of 18d. Exchange being at 10d. in December, the Memorandum column on the debit side of Stores Account will show the equivalent in 18d. dollars of 1,000 currency dollars worth 10d., viz., $555·55.

Now, in January various Stores issues are made on Capital Account, and these are priced in *standard dollars*. When at the end of the month the Journal entry for the issues has to be made in currency (in which the Double-entry System is kept), regard must be had to the value of the currency dollar in the particular month, and just so many currency dollars inserted as are equivalent to the total issues expressed in 18d. dollars. So the Memorandum Standard column in the Stores Account is credited with $277.77, and the Currency column with $476.17 $\left(\text{viz.: } 277.77 \times \frac{18}{10\frac{1}{2}}\right)$.

Similarly, at the end of February, when the Journal entry for the month's transactions is made, the Memorandum Standard column is credited with $277.78, and the Currency column with $454.55 $\left(\text{viz.: } 277.78 \times \frac{18}{11}\right)$.

It may seem at first sight that this is a cumbrous and involved method of keeping the Stores Accounts, but it

must be remembered that the various Stores issued in January and February will be debited to many different impersonal accounts representing Revenue or Capital Expenditure, and that these various accounts do not only consist of Stores issues, but will receive other debits in respect of currency expenditure, such as wages; and that the monthly total of each account has to be converted into sterling in order to ascertain the month's profits. It is, therefore, convenient to turn the total Stores issues affecting each account from standard dollars to currency dollars, in order to fit in with the Double-entry Bookkeeping System, which is kept in currency.

The Stores Account will then appear as follows:—

STORES ACCOUNT.

		Rate	Standard 18d. $	Currency
Dec.	Stores Bought	10d.	555.55	1,000
			555.55	1,000

		Rate	Standard 18d. $	Currency
Jan.	Stores Issued	10½d.	277.77	476.17
Feb.	" "	11d.	277.78	454.55
	Difference written off to London Office Account ..			69.28
			555.55	1,000.00

It will be noticed that although all the Stores are used up, there is still a balance in hand as shown by the Currency column, and this is written off to the Currency column of the London Office Account, having no sterling equivalent, this being treated by London as a memorandum entry and not affecting in any way the Double-entry System of the London books, or the working results.

We will now see the effect of the issues upon the Capital and Revenue Expenditure Accounts. As men-

tioned on p. 13 the Capital Account is ruled with a Memorandum Sterling column, and will therefore appear thus:—

Dr. CAPITAL EXPENDITURE ACCOUNT.

		Rate	Sterling			Currency		
		d.	£	s	d	£	s	d
Jan. To Stores Issues	...	10½	20	16	8	476	17	0

The various Revenue Expenditure Accounts will appear thus:—

REVENUE EXPENDITURE ACCOUNT (under various headings).

Dr.

		$
Feb. To Stores Issues...	... ...	454·55

This figure being converted by the London office at the average rate of the month (11d.) for ascertaining the month's profit, becomes £20 16s. 8d.

We therefore see that stores which, in December, cost £41 13s. 4d. become finally debited to the following accounts:—

	£	s	d
One-half to Capital Expenditure Account in January	20	16	8
One half to various Revenue Expenditure Accounts in February	20	16	8
	£41	13	4

thus proving the correctness of the treatment in the accounts.

Note.—Example 2, at the end of this book (see p. 51), may be worked out here.

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Recapitulation of points to be borne in mind in dealing with fluctuating currency in accounts.

It may be useful to recapitulate here the chief points to be borne in mind in dealing with Fluctuating Currency in Accounts, which have already been explained.

I. Capital Expenditure must be converted into sterling at the rate prevalent when the expenditure is incurred.

II. Revenue Receipts and Expenditure Accounts must be converted into sterling at the average rate of exchange prevailing during the period concerned.

III. Remittances must be converted at the actual rate at which they were made.

IV. Currency Floating Assets and Liabilities must be valued at the rate of exchange prevalent on the date of the Balance Sheet.

V. Stores in hand must be valued at their approximate sterling cost.

VI. Stores Accounts must be treated on a standard basis.

VII. After Capital Expenditure and Profits have been transferred to the London Office Account at the date of closing the books, the balance on this account in the foreign books represents the foreign floating assets, less liabilities. The London office values these at the rate of exchange on the date of the Balance Sheet, and brings down this value as a balance on the Foreign Office Account. This having been done, the amount by which the two sides of the Foreign Office Account do not balance is the profit or the loss on exchange.

VIII. The difference on exchange shown in accounts arises from two kinds of causes:

(*a*) from the variation in the value of a currency floating asset or liability, from the time it is created until the time it is liquidated, and

(*b*) from the employment of *average rates* of exchange in order to arrive at the *approximate* sterling equivalent of transactions taking place in currency.

The difference in exchange cannot therefore be entirely eliminated, as it is impossible either to state in the books the *exact* sterling equivalent of profits at the time when they were made, or to realise them in gold *as and when* they were made.

Frequency with which conversions of book currency figures are made.

It may be well to mention that there can be no hard and fast rule as to how frequently the currency results are to be converted into sterling at average rates of exchange, or how frequently the currency floating assets and liabilities are to be valued in sterling. This depends entirely on the circumstances of each case.

In a country whose exchange fluctuates very little—as, for example, Mexico—the currency results of a year would be converted into sterling at the average rate prevailing throughout the year; and, in this case, the currency floating assets and liabilities would only be valued at the end of each year, and the resulting difference in exchange would be found to be comparatively small.

On the other hand, in a country whose exchange fluctuates violently—as, for instance, Chili—the best course

would be to convert the results of the transactions of each month into sterling at the average monthly rate, otherwise a very large difference in exchange might be shown on the accounts at the end of the year. As regards the currency floating assets and liabilities, it might not be thought worth while to value them in sterling at the end of each month, it being considered that the monthly results arrived at without doing so were correct enough for all practical purposes. In the examples worked out in this book, the currency results of each month have been converted into sterling, and the currency floating assets and liabilities valued at the end of three months, but it must be understood that this has been done merely for convenience. This valuation is a simple matter in the examples we are considering, but in practice it is frequently a somewhat involved and tedious business, which it is not thought desirable to perform every month. For instance, the currency floating assets have to be separated from the sterling floating assets. Many foreign railways, for example, receive payment for part of their freight in the form of sterling bills, and in the same debtor's account, which is kept in currency dollars in order to fit in with the rest of the double-entry bookkeeping system, there may, therefore, be certain items having a sterling origin, and the rest a currency origin. In valuing the balance of the account, the items with a sterling origin must be valued at the original sterling, as they will ultimately come to hand in that form, while the items with a currency origin must be valued in sterling at the rate prevailing on the date of the Balance Sheet.

The two points to be considered in deciding how frequently to convert the currency results and to value the currency floating assets and liabilities are :—

(1) How violently does the exchange fluctuate ?

(2) Are the transactions of the company spread more or less uniformly over the year ?

With regard to the latter point, it will be appreciated that if one is concerned with a company the bulk of whose transactions take place during a particular part of the year, it would be inaccurate to apply an average yearly rate of exchange to the yearly results, if such yearly rate were substantially different from the average rate prevailing during the time when the bulk of the transactions occurred.

It may be somewhat unusual for Revenue Receipts or Expenditure to vary very considerably, but it is quite possible that very large Capital Expenditure may be incurred during quite a short period; and if this expenditure were not converted into sterling at approximately correct rates, Revenue Expenditure might be relieved at the expense of Capital, or *vice versâ*.

We will now work through an example embracing the points which have been dealt with up to the present.

Example embracing points already dealt with.

The following are the balances on the foreign books of an English company at the 1st January 1909, the value of the currency dollar on that date being 9d.

	Dr. Currency	*Cr.* Currency
Stores on hand (50,000 Standard dollars) at 1/6	100,000	
Debtors	60,000	
Creditors		30,000
Bank Balance	18,000	
London Office (£5,550)		148,000
	178,000	178,000

The following is a summary of the transactions of the three months ending 31st March 1909, at the end of which time the books are closed.

	January	February	March
Stores bought locally (Currency)	$5,000	$3,000	$20,000
Stores received from London (Sterling)	£2,000	£1,500	£900
Stores issued on Revenue Account (Standard 1/6 dollars)...	$20,000	$18,000	$11,500
Stores issued on Capital Account (Standard 1/6 dollars) ...	1,000	2,000	3,000
Cash Sales (Currency)	50,000	48,000	52,000
Cash received from Debtors (Currency)	27,000	26,000	23,000
Credit Sales (Currency)... ...	30,000	25,000	28,000
Cash Paid to Creditors for Purchases, Expenses, &c. (Currency)	25,000	28,000	27,000
Revenue Purchases and Expenses credited to Personal Accounts (Currency)	26,000	27,000	30,000
Cash Paid for Wages on Revenue Account (Currency)	9,000	8,000	10,000
Cash Paid for Wages on Capital Account (Currency)	4,000	3,000	5,000
Remitted to London (Currency)	30,000	35,000	32,000

The value of the currency dollar at the 31st March was 10d.
The average rate of exchange for January was 10d.
" " " " February 9d.
" " " " March 11d.

The rates of exchange at which the remittances were made (in the form of Sterling Bills on London) were as follows:—

	£	s	d
The $30,000 in January, 10½d., thus realising	1,312	10	0
" $35,000 " February, 9d. " "	1,312	10	0
" $32,000 " March, 9½d. " "	1,266	13	4

This company converts its transactions into sterling once a month at the average monthly rate ruling, but only re-values its floating assets and liabilities at the end of every three months.

Journal Entries.

January 31st.

		$	$
Stores Account	*Dr.*	5,000	
To Sundry Creditors			5,000
For Stores bought locally.			
($5,000 at 10d. = $2,778 at 1/6.)			
Stores Account	*Dr.*	48,000	
To London Office			48,000
For Stores received from London.			
(£2,000 = $26,667 at 1s. 6d. each.			
= $48,000 at 10d. each.)			
Revenue Expenses	*Dr.*	36,000	
To Stores Account			36,000
For Stores issued on Revenue Account.			
(20,000 1s. 6d. dollars = $36,000 at 10d.)			
Capital Expenditure	*Dr.*	1,800	
To Stores Account			1,800
For Stores issued on Capital Account.			
(1,000 1s. 6d. dollars = $1,800 at 10d.)			
Bank Account	*Dr.*	50,000	
To Revenue Receipts			50,000
Cash Sales for the month.			
Bank Account	*Dr.*	27,000	
To Sundry Debtors			27,000
For Cash received from Debtors.			
Sundry Debtors	*Dr.*	30,000	
To Revenue Receipts			30,000
For Credit Sales for the month.			
Sundry Creditors	*Dr.*	25,000	
To Bank Account			25,000
Revenue Expenses	*Dr.*	26,000	
To Sundry Creditors			26,000

Sundries	*Dr.*	$	$
To Bank Account			13,000
Revenue Expenditure		9,000	
Capital Expenditure		4,000	
For Cash Paid for Wages.			

London Office	*Dr.*	30,000	
To Bank Account			30,000
For Remittance to London.			
(At 10½d., viz.: £1,312 10s.)			

Revenue Account	*Dr.*	9,000	
To Net Revenue Account			9,000
For transfer of balance of former Account, being Net Profit for the month. (At 10d. = £375).			

February 28th.

		$	$
Stores Account	*Dr.*	3,000	3,000
To Sundry Creditors			
For Stores bought locally.			
($3,000 at 9d. = $1,500 at 1s. 6d.).			

Stores Account	*Dr.*	40,000	
To London Office			40,000
For Stores received from London.			
(£1,500 = $20,000 at 1s. 6d. each.			
= $40,000 at 9d. each.)			

Revenue Expenses	*Dr.*	36,000	
To Stores Account			36,000
For Stores issued on Revenue Account.			
(18,000 1s. 6d. dollars = $36,000 at 9d.)			

Capital Expenditure Account ...	*Dr.*	4,000	
To Stores Account			4,000
For Stores issued on Capital Account.			
(2,000 1s. 6d. dollars = $4,000 at 9d.)			

		$	$
Bank Account	*Dr.*	48,000	
To Revenue Receipts			48,000
Cash Sales for the month.			
Bank Account	*Dr.*	26,000	
To Sundry Debtors			26,000
For Cash received from Debtors.			
Sundry Debtors	*Dr.*	25,000	
To Revenue Receipts			25,000
For Credit Sales for the month.			
Sundry Creditors	*Dr.*	28,000	
To Bank Account			28,000
Revenue Expenses	*Dr.*	27,000	
To Sundry Creditors			27,000
Sundries	*Dr.*		
To Bank Account			11,000
Revenue Expenditure		8,000	
Capital Expenditure		3,000	
For Cash paid for Wages.			
London Office	*Dr.*	35,000	
To Bank Account			35,000
For remittance to London (viz.— £1,312 10s. at 9d.)			
Revenue Account	*Dr.*	2,000	
To Net Revenue Account			2,000
For transfer of Balance of former Account, being Net Profit for the month. (At 9d. = £75.)			
March 31st.			
		$	$
Stores Account	*Dr.*	20,000	
To Sundry Creditors			20,000
For Stores bought locally ($20,000 at 11d. = $12,222 at 1s. 6d.)			

		$	$
Stores Account	*Dr.*	19,636	
To London Office			19,636
For Stores received from London. (£900=$12,000 at 1s. 6d. each. =$19,636 at 11d. each.)			
Revenue Expenses	*Dr.*	18,818	
To Stores Account			18,818
For Stores issued on Revenue Account. (11,500 1s. 6d. dollars = $18,818 at 11d.)			
Capital Expenditure Account ...	*Dr.*	4,909	
To Stores Account			4,909
For Stores issued on Capital Account. (3,000 1s. 6d. dollars = $4,909 at 11d.)			
Bank Account	*Dr.*	52,000	
To Revenue Receipts			52,000
Cash Sales for the month.			
Bank Account	*Dr.*	23,000	
To Sundry Debtors			23,000
For Cash received from Debtors.			
Sundry Debtors	*Dr.*	28,000	
To Revenue Receipts			28,000
For Credit Sales for the month.			
Sundry Creditors	*Dr.*	27,000	
To Bank Account			27,000
Revenue Expenses	*Dr.*	30,000	
To Sundry Creditors			30,000
Sundries	*Dr.*		
To Bank Account			15,000
Revenue Expenditure		10,000	
Capital Expenditure		5,000	
For Cash paid for Wages.			

		$	$
London Office	*Dr.*	32,000	
To Bank Account			32,000
For remittance to London (viz., £1,266 13s. 4d. at 9½d.).			

Revenue Account	*Dr.*	21,182	
To Net Revenue Account			21,182
Being transfer of Balance of former Account, being Net Profit for the month. (At 11d. = £970 17s. 0d.)			

Closing Entries.

March 31st.		$	$
London Office Account	*Dr.*	8,708	
To Stores Account			8,708
Adjusting the Balance in the Currency Column of the latter Account according to the Rate of Exchange at the 31st March.			

London Office Account	*Dr.*	22,709	
To Capital Expenditure Account ...			22,709
For transfer of Capital Expenditure to London Books. (£958 6s. 3d.)			

Net Revenue Account	*Dr.*	32,182	
To London Office Account			32,182

For transfer of Net Profits for three months, viz.:—

$9,000 at 10d. =	£375	0	0
$2,000 at 9d. =	75	0	0
$21,182 at 11d. =	970	17	0
$32,182	£1,420	17	0

LEDGER ACCOUNTS.

Dr. STORES ACCOUNT. *Cr.*

		Standard $ 1/6 Dollar	Rate	Currency $			Standard $ 1/6 Dollar	Rate	Currency $
Jan. 1	To Balance.. ..	50,000	9d.	100,000	Jan. 31	By Issues on Revenue Account	20,000	10d.	36,000
31	„ Local Purchases	2,778	10d.	5,000		„ Issues on Capital Account	1,000	10d.	1,800
	„ Stores from London ..	26,667	10d.	48,000	Feb. 28	„ Issues on Revenue Account	18,000	9d.	36,000
Feb. 28	„ Local Purchases	1,500	9d.	3,000		„ Issues on Capital Account	2,000	9d.	4,000
	„ Stores from London ..	20,000	9d.	40,000	Mar. 31	„ Issues on Revenue Account	11,500	11d.	18,818
Mar. 31	„ Local Purchases	12,222	11d.	20,000		„ Issues on Capital Account	3,000	11d.	4,909
	„ Stores from London ..	12,000	11d.	19,636		„ London Office Account		..	8,708
						„ Balance carried down	69,667	10d.	125,401
		$125,167		$235,636			125,167		235,636
April 1	To Balance brought down	69,667	10d.	125,401					

Dr. SUNDRY DEBTORS. *Cr.*

		$			$
Jan. 1	To Balance	60,000	Jan. 31	By Cash	27,000
31	„ Revenue Receipts	30,000	Feb. 28	„ „	26,000
Feb. 28	„ „ „	25,000	Mar. 31	„ „	23,000
Mar. 31	„ „ „	28,000		„ Balance carried down ..	67,000
		$143,000			$143,000
Apr. 1	To Balance brought down	67,000			

SUNDRY CREDITORS.

		$			$
Jan. 31	To Cash	25,000	Jan. 1	By Balance	30,000
Feb. 28	„ „	28,000	31	„ Stores bought	5,000
Mar. 31	„ „	27,000		„ Sundry Expenses	26,000
	„ Balance carried down.. ..	61,000	Feb. 28	„ Stores bought	3,000
				„ Sundry Expenses	27,000
			Mar. 31	„ Stores bought	20,000
				„ Sundry Expenses	30,000
		$141,000			$141,000
			Apr. 1	By Balance brought down ..	61,000

Dr. BANK ACCOUNT. *Cr.*

			$				$
Jan. 1	To Balance	.. ..	18,000	Jan. 31	By Sundry Creditors	.. ..	25,000
31	„ Revenue Receipts	.. ..	50,000		„ Wages		13,000
	„ Sundry Debtors ..	.. ..	27,000		„ London Office (£1,312 10s.) ..		30,000
Feb. 28	„ Revenue Receipts..	.. ..	48,000	Feb. 28	„ Sundry Creditors		28,000
	„ Sundry Debtors ..	.. ..	26,000		„ Wages		11,000
Mar. 31	„ Revenue Receipts	.. ..	52,000		„ London Office (£1,312 10s.) ..		35,000
	„ Sundry Debtors ..	.. ..	23,000	Mar. 31	„ Sundry Creditors		27,000
					„ Wages		15,000
					„ London Office (£1,266 13s. 4d.)		32,000
					„ Balance carried down ..		28,000
			$144,000				$244,000
Apr. 1	To Balance brought down	..	28,000				

Dr LONDON OFFICE ACCOUNT. *Cr.*

		Sterling £ s d	Rate	Currency $			Sterling £ s d	Rate	Currency $
Jan. 31	To Remittances	1,312 10 0	10½d.	30,000	Jan. 1	By Balance ..	5,550 0 0	9d.	148,000
Feb. 28	„ „	1,312 10 0	9d.	35,000	31	„ Stores ..	2,000 0 0	10d.	48,000
Mar. 31	„ „	1,266 13 4	9½d.	32,000	Feb. 28	„ „ ..	1,500 0 0	9d.	40,000
	„ Stores Account adjusting currency column	..	..	8,708	Mar. 31	„ „ ..	900 0 0	11d.	19,636
	„ Capital Expenditure	958 6 3	..	22,709		„ Net Profits for 3 months ..	1,420 17 0	..	32,182
	„ Balance carried down	6,642 4 0	10d.	159,401		„ Profit on Exchange ..	121 6 7	..	..
		£11,492 3 7		$287,818			£11,492 3 7		$287,818
					Apl. 1	By Balance b/d	6,642 4 0	10d.	159,401

Dr. REVENUE RECEIPTS AND EXPENSES ACCOUNT. *Cr.*

		$			$
Jan. 31	To Stores issued on account of Revenue	36,000	Jan. 31	By Cash Sales	50,000
	„ Sundry Creditors	26,000		„ Credit Sales	30,000
	„ Wages	9,000			
	„ Balance transferred to Net Revenue Account	9,000			
		$80,000			$80,000
Feb. 28	To Stores issued on account of Revenue	36,000	Feb. 28	By Cash Sales	48,000
	„ Sundry Creditors	27,000		„ Credit Sales	25,000
	„ Wages	8,000			
	„ Balance transferred to Net Revenue Account	2,000			
		$73,000			$73,000
Mar. 31	To Stores issued on account of Revenue	18,818	Mar. 31	By Cash Sales	52,000
	„ Sundry Creditors	30.000		„ Credit Sales	28,000
	„ Wages	10,000			
	„ Balance transferred to Net Revenue Account	21,182			
		$80,000			$80,000

Dr. NET REVENUE ACCOUNT. *Cr.*

			$			$
Mar. 31	To London Office ..	(£1,240 17s.)	32,182	Jan. 31	By Balance of Revenue Receipts and Expenses Account	(£375) 9,000
				Feb. 28	„ Do. do.	(£75) 2,000
				Mar. 31	„ Do. do.	£970 17s.) 21,182
			$32,182			$32,182

Dr. CAPITAL EXPENDITURE ACCOUNT. *Cr.*

		Sterling £ s d	Rate	Currency $			Sterling £ s d	Rate	Currency $
Jan. 31	To Stores issued on Capital Account ..	75 0 0	10d.	1,800	Mar. 31	By Transfer to London Office Account ..	958 6 3	—	22,709
	„ Wages paid	166 13 0	10d.	4,000					
Feb. 28	„ Stores issued on Capital Account ..	150 0 0	9d.	4,000					
	„ Wages paid	112 10 0	9d.	3,000					
Mar. 31	„ Stores issued on Capital Account ..	224 19 11	11d.	4,909					
	„ Wages paid	229 3 4	11d.	5,000					
		£958 6 3		$22,709			£958 6 3		$22,709

NOTE.—Example 3 at the end of the book (see p. 52) may be worked out here.

"Permutation" or "Conversions" Account.

Up to the present, no mention has been made of the "Permutation" or "Conversions" Account, which is to be found in operation under certain systems of dealing with fluctuating currency in accounts, and it is therefore necessary to give a short explanation of the use of such an account.

It will be noticed, in the examples already quoted, that certain transactions take place in gold (as, for instance, Stores sent out from England), while others take place

in currency (such as Revenue Receipts and Expenditure abroad). The method of dealing with the transactions, which has been already explained, is to work the whole Double-entry Bookkeeping System in currency, to keep in memorandum the standard equivalents of transactions having a standard or gold origin, and to take such standard origin into account in converting back the whole of the results into sterling at certain intervals.

An alternative method, which involves the use of the Permutation or Conversions Account and has now to be explained, is to keep two sets of books abroad, one containing the standard or gold accounts, and the other the paper or fluctuating currency accounts. To make each of these sets of books self-balancing, a "Conversions" Account is opened, containing a Gold and a Paper column, the Gold column forming part of the Double-entry System of the Gold books, and the Paper column of the Paper books.

The balance on the Gold column represents the gold equivalent of the net total of all the balances in the Paper books, and the balance on the Paper column represents the paper equivalent of the net balances in the Gold books. All transfers from the Gold books to the Paper books, or *vice versâ*, must be made through the medium of the Conversions Account.

Explanation of example following.

The example which is worked out on the following pages illustrates the detailed working of the "Conversions Account," and the Journal entries in the Paper and Gold books should be examined in the order in which they are numbered.

It will be noticed that the Capital Expenditure, Stores, and London Office Accounts are kept in the Gold books, and the Revenue Accounts and the Currency Bank Accounts and Debtors and Creditors in the Paper books.

Whenever a Journal entry has to be made which affects both a Gold and a Paper Account it has to that extent to be duplicated in each set of books. For instance, if Stores are issued on Revenue Account, the Stores Account in the Gold books has to be credited and Expenditure Accounts in the Paper books have to be debited; therefore an entry is made in the Gold books, crediting Stores Account and debiting the Gold column in the "Conversions" Account, while in the Paper books a further entry has to be made debiting the Expenditure Accounts and crediting the Paper column in the Conversions Account (see Journal entries 1 and 2). In just the same way, if the Currency Bank Account which exists in the Paper books is drawn on for Capital Expenditure which is to be found in the Gold books, a Journal entry is made in the Paper books debiting the Paper column of the Conversions Account and crediting the Bank Account, while a further entry is made in the Gold books debiting Capital Expenditure and crediting the Gold column in the Conversions Account (see Journal entries 3 and 4). Entries such as Nos. 5, 6, 7, and 8 in the Paper books need no corresponding entry in the Gold books, as they only affect Paper Accounts. Similarly, entry No. 13 in the Gold books requires no corresponding entry in the Paper books, as both accounts affected are Gold Accounts.

When, at the end of the financial period, the Profits and the Capital Expenditure are transferred to the London Office, the currency floating assets less liabilities shown in the Paper books, correspond to the currency figure brought down as a credit balance on the Conversions Account. The balance on the Gold column of the Conversions Account will be a debit one, and purports to represent the gold value of such assets, less liabilities. This balance, however, has to be adjusted according to the value of the currency assets, less liabilities, at the date of the Balance Sheet; when such adjustment has been made, the Gold column of the Conversions Account will not balance. Whatever the difference is must be transferred to the London Office Account as the profit or the loss on exchange, according to the side on which the difference falls.

In the example which follows, the $6,000 currency which is brought down as the credit balance on the Paper column of the Conversions Account, is represented by the balances on the Paper books, viz. :—

	$
Bank Balance	1,000
Debtors	6,000
	7,000
Less Creditors	1,000
	$6,000

This $6,000 is converted at the rate of 10d. prevailing on the 31st January into $3,333 gold dollars, which sum is brought down as a debit balance on the Gold column of the Conversions Account. It will now be found that the

debit Gold column adds up short by $55, so that a Journal entry is made in the Gold books, debiting the Conversions Account and crediting London Office with this sum, which represents a profit on exchange.

The foregoing explanations should enable the working out of the example to be clearly followed.

BALANCES at 1st January shown in Currency.

	$	$
Stores in hand (10,000 Standard 1s. 6d. dollars)	20,000	
Debtors	5,000	
Cash at Bank...	3,000	
Creditors		2,000
London Office (£862 10s.)		26,000
	$28,000	$28,000

(Value of Currency Dollar at 1st January, 9d.).

These balances would be divided over the Gold and the Paper books as follows :—

GOLD BOOKS. TRIAL BALANCE, 1st January.

	1s. 6d. $		1s. 6d. $
Stores Account ...	10,000	London Office Account	13,000
Conversions Account	3,000		
	$13,000		$13,000

PAPER BOOKS. TRIAL BALANCE, 1st January.

	Currency		Currency
Debtors	5,000	Creditors	2,000
Bank Balance ...	3,000	Conversions Account	6,000
	$8,000		$8,000

TRANSACTIONS FOR JANUARY.

Stores used on Revenue Account	3,000	Standard 1s. 6d. dollars
„ „ „ Capital Account	2,000	„ „ „
Wages paid on Revenue Account	6,000	Currency dollars
„ „ „ Capital Account	3,000	„ „
Credit Sales	20,000	„ „
Revenue Expenses	1,000	„ „
Receipts from Debtors	19,000	„ „
Payments to Creditors	2,000	„ „
Remitted to London (at 9d.) ...	10,000	„ „

Average Rate of Exchange for January, 9½d.
Rate of Exchange at 31st January, 10d.

JOURNAL ENTRIES.—GOLD BOOKS.

		$	$
(1)			
Capital Expenditure	*Dr.*	2,000	
Conversions Account...		3,000	
To Stores			5,000
For Stores issued for the month on Capital and on Revenue Account respectively.			
(4)			
Capital Expenditure Account ...	*Dr.*	1,583	
To Conversions Account			1,583
For Capital Wages paid out of Currency Bank Account. ($3,000 at 9½d. = $1,583 at 1s. 6d.)			
(10)			
London Office	*Dr.*	5,000	
To Conversions Account			5,000
Being remittance to London of $10,000 currency at 9d.			
(12)			
Conversions Account	*Dr.*	3,861	
To London Office			3,861
Being transfer of Net Revenue of $7,316 currency at 9½d. (= $3,861 at 1s. 6d.)			

(13)		$	$
London Office Account	*Dr.*	3,583	
To Capital Expenditure			3,583
For Capital Expenditure transferred to London.			

(14)			
Conversions Account	*Dr.*	55	
To London Office			55
Being Profit on Exchange.			

Journal Entries.—Paper Books.

(2)		$	$
Revenue Expenses Account ...	*Dr.*	5,684	
To Conversions Account			5,684
For Stores issued on Revenue Account for the month.			
($3,000 at 1s. 6d. = $5,684 at 9½d.)			

(3)			
Revenue Expenses Account ...	*Dr.*	6,000	
Conversions Account...		3,000	
To Bank Account			9,000
For Wages paid during month on Revenue Account and Capital Account respectively.			

(5)			
Sundry Debtors	*Dr.*	20,000	
To Revenue Receipts			20,000
Being Credit Sales for the month.			

(6)			
Revenue Expenses	*Dr.*	1,000	
To Sundry Creditors			1,000
For Revenue Expenses for the month.			

OF THE UNIVERSITY OF CALIFORNIA

		$	$
(7)			
Bank Account	*Dr.*	19,000	
To Sundry Debtors			19,000
Receipts from Debtors for month.			
(8)			
Sundry Creditors	*Dr.*	2,000	
To Bank Account			2,000
Payments to Creditors for month.			
(9)			
Conversions Account	*Dr.*	10,000	
To Bank Account			10,000
Remittance to London at 9d.			
(11)			
Revenue Account	*Dr.*	7,316	
To Conversions Account			7,316
For transfer of Net Revenue to London Office.			

LEDGER ACCOUNTS.—PAPER BOOKS.

Revenue Account.

		$			$
Jan. 31	To Conversions A/c, being Stores issued on Revenue Account	5,684	Jan. 31	By Credit Sales	20,000
	„ Bank Account—Wages	6,000			
	„ Creditors, for Expenses	1,000			
	„ Conversions Account	7,316			
		$20,000			$20,000

Bank Account.

		$			$
Jan. 1	To Balance	3,000	Jan. 31	By Wages paid	9,000
31	„ Sundry Debtors ..	19,000		„ Sundry Creditors ..	2,000
				„ Conversions Account (Remittance to London)	10,0000
				„ Balance	1,00
		$22,000			$22,000
Feb. 1	To Balance	1,000			

SUNDRY DEBTORS.

		$			$
Jan. 1	To Balance	5,000	Jan. 31	By Cash	19,000
31	„ Revenue Receipts ..	20,000		„ Balance	6,000
		$25,000			$25,000
Feb. 1	To Balance	6,000			

SUNDRY CREDITORS.

		$			$
Jan. 31	To Cash	2,000	Jan. 1	By Balance	2,000
	„ Balance	1,000	31	„ Revenue Expenses..	1,000
		$3,000			$3,000
			Feb. 1	By Balance	1,000

TRIAL BALANCE OF PAPER BOOKS, 31st January.

	$	$
Bank Balance	1,000	
Debtors	6,000	
Creditors		1,000
Conversions Account		6,000
	$7,000	$7,000

LEDGER ACCOUNTS, GOLD BOOKS (Kept in Standard 1s. 6d. dollars).

CAPITAL EXPENDITURE.

		$			$
Jan. 31	To Stores issued	2,000	Jan. 31	By London Office	3,583
	„ Wages Paid	1,583			
		$3,583			$3,583

LONDON OFFICE ACCOUNT.

		$			$
Jan. 31	To Coversions Account, being Remittance from Currency Bank Account	5,000	Jan. 1	By Balance..	13,000
"	Capital Expenditure for the month ..	3,583	31 "	Conversions Account, being Profits transferred	3,861
"	Balance carried down	8,333	"	Conversions Account, being Profit on Exchange	55
		$16,916			$16,916
			Feb. 1	By Balance brought down	8,333

STORES ACCOUNT.

		$			$
Jan. 1	To Balance	10,000	Jan. 31	By Sundries, being issues for the month ..	5,000
			"	Balance carried down	5,000
		$10,000			$10,000
Feb. 1	To Balance	5,000			

CONVERSIONS ACCOUNT.

		Currency $	Gold $			Currency $	Gold $
Jan. 1	To Balance		3,000	Jan. 1	By Balance	6,000	
31	" Stores Account ..		3,000	31	" Capital Expenditure		1,583
"	Revenue Expenses	3,000		"	London Office ..		5,000
"	Bank Account ..	10,000		"	Revenue Expenses	5,684	
"	London Office A/c, Profits transferred		3,861	"	Revenue Account	7,316	
"	London Office A/c, Profit on Exchange		55				
"	Balance c/d ..	6,000			By Balance c/d ..		3,333
		$19,000	9,916			$19,000	9,916
	To Balance b/d.. ..		3,333	Feb. 1	By Balance b/d ..	6,000	

TRIAL BALANCE OF THE GOLD BOOKS AT 31st January.

	$	$
Stores	5,000	
Conversions Account	3,333	
London Office Account ...		8,333
	$8,333	$8,333

Note.—Example 4 at the end of this book (see p. 53) may be worked out here.

Differences in exchange as affecting Capital Expenditure.

It will be noticed that nothing has as yet been mentioned as to profits or losses on exchange in relation to Capital Expenditure. It will be evident that where Capital Expenditure is incurred in a fluctuating currency, and the figures relating thereto are converted into sterling at average rates of exchange, a difference in exchange will occur in the same way as when dealing with revenue results.

In cases where no Revenue Expenditure is being incurred at the same time, the whole of the loss or the profit on exchange must be debited or credited to Capital, as it represents the amount by which Capital Expenditure has been under or over-charged by reason of the adoption of average rates of exchange.

Where, however, expenditure on Capital and on Revenue Account is being incurred simultaneously, the matter becomes more difficult to deal with, and the mode of treatment must, to a large extent, depend on the circumstances of the particular case.

Where the Capital Expenditure is quite small in proportion to the Revenue Expenditure, and the difference in exchange shown at the end of the year is inconsiderable, it is usual to write such a difference off to Profit and Loss Account, and not to attempt to allocate it as between Capital and Revenue.

If, however, the difference on exchange is likely to be a large one, and the Capital Expenditure is considerable, it becomes necessary either (*a*) to separate the actual funds used for Capital and for Revenue Expenditure ; or (*b*) to adopt such rates of conversion for the Capital

Expenditure incurred in currency as will show such Capital Expenditure at very nearly its true sterling cost, the difference in exchange shown on the books as a whole then being treated as having arisen entirely on Revenue Account.

Where it is possible to keep a special currency banking account for Capital Expenditure, and to pay thereinto remittances from England for such a purpose, the exact sterling cost of the Capital Expenditure can be arrived at. Where, however, it is not convenient to keep such a banking account, and where, in addition to remittances from London, there are currency profits earned abroad and used to meet Capital Expenditure, it should be possible to ascertain approximately how much of the Capital Expenditure was met by funds sent out from London and how much by currency profits retained abroad. The former amount should be converted at the rates at which the remittances were sent from London during the period, and the latter at the average rates used to convert the results of the Revenue transactions. By this method, the Capital Expenditure would be valued as nearly as possible under the circumstances at its true sterling cost, and the difference in exchange shown on the books as a whole would be written off to Revenue.

Methods of dealing with a Revenue difference in exchange.

With regard to the writing off to Revenue of differences in exchange before mentioned, the following reservation should be made—namely, that if a considerable portion of a profit on Exchange arises from a high valuation of the currency floating assets at the date of the Balance Sheet, and if such assets afterwards realised a

much lower figure owing to a subsequent fall in exchange, it would be prudent to hold a portion of the profit on exchange in suspense, instead of crediting it wholly to Profit and Loss Account.

Where a difference in exchange is written off, it is usual to show it as a separate item on the Accounts, but an alternative method of dealing with it is to spread it over the whole of the Revenue and Expenditure Accounts in proportion to the amounts of such accounts. For instance, if the Gross Revenue of a business is £10,000 and the expenses £5,000, and there is a debit difference in exchange of £300, it would be assumed that the Gross Revenue had been over-estimated by £200 and the Expenses under-estimated by £100. The debit for £300 would then disappear, £200 of it being deducted from the Gross Revenue Accounts and £100 charged to the various Expense Accounts, in proportion to the amount of such accounts.

EXAMPLES FOR WORKING OUT.

Example 1.

Balances on Foreign Books at 1st January :—

	$	$
Currency Debtors	50,000	
Currency Creditors		10,000
Currency Bank Balance	20,000	
London Office		60,000
	$70,000	$70,000

Rate of Exchange at 1st January ... 10d.

Transactions for three months to 31st March:—

	Jan.	Feb.	March
	$	$	$
Gross Revenue receivable ...	40,000	50,000	60,000
Revenue Expenses payable ...	28,000	38,000	47,000
Cash received from Debtors ...	30,000	52,000	65,000
Cash paid to Creditors... ...	29,000	37,000	46,000
Cash remitted to London ...	10,000	15,000	12,000
	at 10½d.	at 9d.	at 10d.
Average Rates of Exchange ...	10d.	9d.	10½d.

Rate of Exchange at 31st March, 11d.

Write up the foreign Journal and Ledger for the three months and close the foreign books at the 31st March.

EXAMPLE 2.

Stores Accounts:

The Stores in hand abroad on 1st January cost £10,000, the rate of exchange on that day being 9d.

	Jan.	Feb.	March
The following Stores are received from London	£5,000	£3,000	£4,000
	$ *Currency*		
The following Stores are bought locally in currency	2,000	3,000	1,000
	Standard 1/6 $		
The following Stores are issued in Standard 1/6 Dollars on Revenue Account	40,000	20,000	18,000
	$ *Currency*		
The other debits to Revenue Expenditure Accounts in currency are	50,000	60,000	70,000
The gross credits to Revenue Account in currency are ...	200,000	150,000	120,000
Average Rates of Exchange ...	10d.	11d.	10d.

Rate of Exchange at 31st March, 10½d.

Write up the Stores Accounts for the three months; incorporate the Stores entries with the other entries of which particulars are given, and close the books at 31st March.

EXAMPLE 3.

Balances on Foreign Books at 1st January :—

	$ Currency	$ Currency
Stores	20,000	
Debtors	5,000	
Creditors		2,000
Bank Account	20,000	
London Office		43,000
	$45,000	$45,000

Rate of Exchange at 1st January 1/-

Transactions for the year :—

Stores received from London	£5,000
Stores bought locally ...	Currency $40,000 (to be credited to Creditors)
Stores issued on Capital Account	(Standard 1/6 $) $50,000
Stores issued on Revenue Account	(Do.) $10,000
Gross Income	Currency $100,000 (to be debited to Debtors)
Revenue Expenditure (other than Stores issues) ...	Do. $50,000 (to be credited to Creditors)
Capital Expenditure (other than Stores issues) ...	Do. $5,000 (to be credited to Creditors)
Receipts from Debtors ...	Do. $80,000
Payments to Creditors, &c.	Do. $30,000

Remittances to London :—

$ Currency.

20,000 at 12d.

20,000 at 12¼d.

10,000 at 12½d.

Average Rate of Exchange for the year, 12d.

Rate at 31st December, 12½d.

Write up the books for the year, and close them as on 31st December.

EXAMPLE 4.

Work out the foregoing question, opening Gold Books in 1/6 dollars and Paper Books in currency, and using a "Permutation" or "Conversions" Account.

INDEX.

	PAGE
Assets, Fixed, Treatment of	10
,, Floating, Treatment of	10
Average Rate of Exchange, Employment of	6
Branch Office and Head Office, Current Account between ..	9
Capital Expenditure, Treatment of	10
Conversion of Capital Expenditure	10
,, Revenue Expenditure	6
Conversions Account..	38
Current Account between Head Office and Branch	9
Difficulties in Exchange—	
How Arising	20
How Dealt with..	49
In Relation to Capital Expenditure	48
Examples for Working out	50-53
Expenditure, Capital, Treatment of	10
,, Revenue, Treatment of	6
Financing of English Company having Operations Abroad ..	8
Floating Assets and Liabilities, Treatment of	10
Frequency with which Revenue Results are Converted	27
Gold Basis for Stores Accounts	21
Head Office and Branch, Current Account between	9
Liabilities, Treatment of	10

PAGE

Permutation Account.. 38

Profits, How Converted 6

„ Relation to Remittances.. 8

Remittances, Home: How Converted 26

„ Relation of, to Profits 8

Revenue Receipts and Expenses, Treatment of 6

Rules for Treating Fluctuating Currency in Accounts 26, 27

Standard Basis for Stores Accounts 21

Stores Accounts, Treatment of 21

Valuation of Fixed Assets 10

„ Floating Assets and Liabilities 10

Writing off Differences in Exchange 50

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